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No. 243

IN THE

Supreme Court of the United States

OCTOBER TERM, 1968

CITIZEN PUBLISHING COMPANY, STAR PUBLISHING COMPANY, TUCSON NEWSPAPERS INCORPORATED, ARDEN PUBLISHING COMPANY AND WILLIAM A. SMALL, JR.,
Appellants,

v.

UNITED STATES OF AMERICA, *Appellee.*

On Appeal From the United States District Court for the District of Arizona

REPLY BRIEF FOR APPELLANTS

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SUMMARY

The government's brief:

1. Begs the essential question, by assuming that the challenged provisions of the operating agreement constitute "price fixing," "profit pooling," and "market allocation" and by assuming that the District Court's conclusion that Citizen was not on the verge of going

out of business in 1940 supports the summary judgment of *per se* violation of the Sherman Act; and

2. Ignores that this case tests for the first time the important social and economic questions whether newspaper operating agreements provide a reasonable and lawful way to preserve competitive journalistic voices in a significant segment of the few remaining cities which are exposed to competition between newspapers on the journalistic level; and

3. In effect urges a rule compelling the destruction of one of two existing independent and competing journalistic voices in order to create a speculative possibility that after such destruction occurs another newspaper may be launched.

Preliminarily, one significant concession in the government's brief is to be noted (G.B. 19-20): "If, on the other hand, this court were to reverse on the Section 1 issue such reversal also would undermine the District Court's holding of illegal monopolization." In this the government agrees with the statements to the same effect in our opening brief 57-61.

I. The Government Is Wrong When It Argues That the Failing Company Doctrine Does Not Apply and That the Evidence Did Not Establish That Citizen Was a Failing Company (See Government's Brief, pp. 26-32)

With respect to the failing company doctrine, the government makes two principal arguments; first, that the District Court held that the evidence did not establish that Citizen was a failing company, and second, that the failing company doctrine is not applicable to the operating agreement. We submit that the government is wrong in both respects.

Our opening brief (A.B. 41-48)[1] set forth the facts showing that by 1940 Citizen for a number of years had been a failing company, having liabilities far exceeding its assets, and being unable to pay its current debts. We also demonstrated that the District Court's conclusion that Citizen in 1940 was not on the verge of going out of business (F. 17) was in direct conflict with its findings of fact relating to the financial condition of Citizen and thus clearly erroneous (F. 12, 13, 14, 15, 21 and 22).

In its brief the government states that at the close of trial the District Court denied appellants' motion to set aside the summary judgment and found that the essential elements of the failing company defense had not been established (G.B. 19, 25-26).

The record shows that at the close of trial defendants moved the Court to set aside the summary judgment, and reopen the case so as to give the government and defendants an opportunity to adduce evidence on the Section 1 issue (see docket entry 155, A. 17). The Court when denying that motion did not find that the failing company defense had not been established as now urged by the government. It refused to consider evidence that Citizen was a failing company because, as the government points out in its brief (G.B. 24), the Court thought the evidence was irrelevant.[2]

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[1] As used herein, "A." refers to the Appendix to appellants' and appellee's briefs; "F." to the trial court's findings of fact; "G.B." to the brief for the United States; and "A.B." to appellants' opening brief.

[2] Unlike findings 12-15, 21 and 22 which relate to the financial facts regarding Citizen, finding 17 was made by the Court without hearing argument on that finding (cf. *United States* v. *Diebold, Inc.* (1962), 369 U.S. 654, 655).

The government argues that in the year 1939 just before entering the operating agreement, Citizen's situation became greatly improved. The argument is premised on an invalid comparison of 1939 data with data for the single year 1938. Thus it states that in 1939 Citizen's circulation had vastly increased over 1938 and that its deficit was reduced below that of 1938 by 16% (G.B. 27). The government fails to point out that the situation in 1939 was an improvement over 1938 *only* because 1938 was a particularly bad year for Citizen. The company's circulation and losses for the earlier years had been as follows (A. 495, 499):

Year	Circulation	Deficit
1932		$(21,258)
1933		(8,453)
1934		(21,514)
1935	10,950	(19,865)
1936	10,455	(19,317)
1937	10,001	(22,151)
1938	8,615	(30,596)
1939	10,532	(25,821)

When all the figures are examined, it becomes readily apparent that circulation in 1939 was not much better than in 1937 or 1936, and somewhat less than in 1935. Obviously 1938 is not a proper year for comparison of Citizen's losses, because losses in 1938 were greater than in any year since 1932 ($30,596). Citizen's deficit in 1939 was in fact more than $4,500 greater than its average losses for the period 1932 to 1940 (A.B. 8).

As against the government's claim that Citizen, in competition with Star, was able to increase its advertising lineage from 1938 to 1939 "despite higher prices" than Star (G.B. 28), the District Court found that Citizen was unable to raise its advertising rates because of

the competition of Star (F. 176), and that despite its higher prices Citizen sold advertising "below the rates on its rate card because of the competition from Star" (F. 178). In any event, the overall picture shows that the year 1939 did not hold out particular promise for Citizen. Examination of the general trend from 1932 through 1939 demonstrates that Citizen was steadily declining (A. 495, 499, 500). The government does not rebut this by focusing on the single year 1938.

Plaintiff acknowledges that Small was an experienced newspaper man (G.B. 5) and that Citizen had a "competent staff" and a "substantial readership" (G.B. 27). Nevertheless, Small and his staff were unable to stem Citizen's operating deficit or its loss of assets. When Small and Johnson purchased Citizen, they contributed $25,000 in working capital (F. 14). At least $79,000 was contributed by its stockholders during the next four years, and $30,000 was advanced to Citizen from other sources (F. 15). Despite all this, the government complains that Small should have done something more before entering into the operating agreement with Star. It says that Citizen should have considered alternatives (G.B. 30-31) and suggests that it should have tried a "unified plant and joint distribution" system (G.B. 31). The government does not suggest, nor did it offer any evidence, that such a plan would have yielded savings sufficient to defray Citizen's operating deficit. The fact is that the savings from the joint use of mechanical facilities was very small and not nearly enough to offset Citizen's losses. (See A.B. 46) Thus it is readily apparent why Star and Citizen, after studying various means of reducing operating costs and preparing numerous projections and schedules of savings, decided that only the operating agree-

ment finally adopted would yield the savings sufficient for the survival of Citizen (A. 148-49).

The government's suggestion that the joint operation of the press room and circulation trucks alone would have yielded sufficient savings to enable Citizen to survive is pure speculation. This Court in *International Shoe Co.* v. *Comm'n* (1930), 280 U.S. 291, held that the officers and stockholders of a corporation are best able to judge these considerations. In that case, it had been suggested that instead of an outright sale of assets, other alternatives should have been adopted such as borrowing from banks or placing the corporation in the hands of a receiver. The Court concluded:

> As between these and all other alternatives, and the alternative of a sale such as was made, the officers, stockholders and creditors, thoroughly familiar with the factors of a critical situation and more able than commission or court to foresee future contingencies, after much consideration, felt compelled to choose the latter alternative. There is no reason to doubt that in so doing they exercised a judgment which was both honest and well informed; and if aid be needed to fortify their conclusion, it may be found in the familiar presumption of rightfulness which attaches to human conduct in general. *International Shoe Co.* v. *Comm'n,* 280 U.S. 291, 302.

The government's reliance on *United States* v. *Third National Bank* (1968), 390 U.S. 171, 189, 190, is misplaced. In that case, the question was what means should be developed under the Bank Merger Act of 1966 to avoid a merger of banks which without question would restrain or probably restrain competition. It was conceded that the acquired bank was not a failing company. It earned substantial net profits in the

preceding year. While it appeared to be in difficulty, it was far from being insolvent, bankrupt or in a failing condition within the meaning of *International Shoe*. In this case, Citizen was in fact bankrupt. Plaintiff cites no authority, and we know of none, which would require an actual failing company to undertake some speculative scheme as a remedy for its ills before entering into a merger.

Plaintiff notes that Small had not employed a broker to sell Citizen. No authority is cited which would require him to do so. In any event, there is testimony in this case by an eminent newspaper broker familiar with the finances of Citizen in 1940 that the company could not have been sold at that time to a publisher outside Tucson who had not made prior arrangements to merge the paper completely with Star (A. 229-230).

The government argues that Citizen should have been offered for sale to an outside publisher who would attempt to rehabilitate the newspaper. But in urging that this should have been done before the operating agreement was entered into with Star, the government overlooks that such a sale and effort at rehabilitation by an experienced newspaper man had taken place just four years before. At the trial the government elicited testimony that Citizen in 1935 was approaching bankruptcy (A. 238). Shortly thereafter the owner of Star turned down several proposals of prospective purchasers of Citizen to merge with Star (A. 178-182). The Hitchcock Estate then sold Citizen, in a failing condition, to Small and Johnson. Thereafter serious attempts at rehabilitation were made by injecting more than $100,000 of new money, by organizing new management, by supplying the company with what the government describes as a "competent staff" and by organ-

izing a "substantial readership" (G.B. 27). But these efforts were not enough to overcome the approaching bankruptcy and by 1940 the record shows that Citizen had in fact become bankrupt (A.B. 9-10).

Thus, on this record it is clear that Citizen in 1940 was indeed a failing company, that there was no prospective purchaser—not even Star—and that the only alternative to dissolving Citizen was to enter the operating agreement.

II. The Government Is Wrong in Its Contention That Citizen Could Survive If the Provisions in the Operating Agreement for Joint Advertising and Circulation Departments Are Abrogated (See Government's Brief, pp. 32-34)

The government notes that Star and Citizen, under the order of the District Court, are free to continue their joint use of production and distribution facilities (G.B. 32). It is clearly wrong in its assertion that the record does not show that Citizen would fail under such a limited arrangement.

The record is replete with the testimony of experts in the newspaper field familiar with joint operating agreements that Citizen could not survive without the savings yielded by the joint advertising and circulation departments (e.g., A. 126, 129, 137, 173, 223-225, 232-233, 371, 529-530, 553-554). In addition, an experienced newspaper business consultant, having special knowledge of operating agreements and the financial affairs of Star and Citizen, testified that if the provisions in the operating agreement for distribution of revenues by fixed formula and for combined advertising and circulation departments should be abrogated, Citizen would again be forced to a failing condition and eventually be compelled to dissolve or merge with Star (A.

223-225, 232-233). The government produced no evidence on this subject.

Appellants also presented a pro forma statement prepared by a person who the government conceded was an expert in this field.[3] (A. 309-310). The pro forma statement showed that without the joint advertising and circulation departments Citizen, in the years 1962-1964, would have sustained an average loss of more than $75,000 per year (A. 501). To be on the conservative side, the pro forma analysis presented an optimistic picture of what Citizen's condition would have been.[4]

The pro forma statement was admitted in evidence without objection (A. 319-320). It shows that without the operating agreement in the years 1962-1964 Citizen would have operated at a loss, and Star at a profit just as they did in the years before the operating agreement was executed. This consistency lends special credence to the analysis.

It is significant that the pro forma analysis also shows that in each of the three years 1962-1964 Citizen would sustain substantial losses and that Star would earn

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[3] The expert was a partner in a national accounting firm (A. 309). The pro forma statement showed what Citizen's financial condition would have been in 1962-1964 in the absence of combined advertising, circulation and business departments but with joint use of production and distribution facilities. This statement was furnished the government for study weeks before trial and was received in evidence without objection (A. 319-320).

[4] For example, it attributed to Citizen a large amount of advertising lineage it could not have sold without the operating agreement. This was lineage which, under the operating agreement, accrued to Citizen through Saturday and Monday optional combination sales with the Sunday Star (A. 350-351). It brought in important revenues (A. 377-378). Today all advertising—national, local display, and classified—is sold separately, or on an optional combination rate basis. (*Standard Rate and Data*, December 11, 1968, p. 112).

profits in the realm of $350,000 to $500,000. If in one year the analysis had shown that Citizen would have sustained a profit it could be argued that perhaps there would be some hope that Citizen could survive. But this was not the case.

Having offered no evidence on the ability of Citizen to survive wtihout combined advertising and circulation departments, the government now attacks the pro forma analysis. First, it says that despite increases in advertising and circulation promotional expense, the statement assumes that the advertising and circulation revenues of the two companies would have remained the same as they were under the operating agreement (G.B. 33). But it is perfectly logical to project that if Star and Citizen were to increase their promotional expenses in equal amounts, these efforts would have resulted in a virtual stand-off. In fact, the testimony was that these promotional efforts would be required simply to maintain the present position of each company (A. 173, 344).

As the government points out, the expert witness acknowledged that a 2 per cent increase in Citizen's revenues would have equaled its losses in 1964. It is, of course, equally true that a 2 per cent decrease in Citizen's revenues would have doubled its losses. The witness was careful to point out that there was no basis whatsoever for predicting that Citizen could, in the face of Star's stronger financial position, increase its net revenues by 2 per cent (A. 349-350, 352).[5]

Finally, the government argues that if the pro forma statement had been formulated on a cash flow basis

[5] The witness pointed out that if Citizen were to increase its advertising rates, the effect of such a rate increase could not be computed because the effect of Star's responding rate changes could not be evaluated (A. 348-349).

(omitting depreciation), it would indicate a profit to Citizen of $52,000 in 1964 (G.B. 33). The argument is not sound because depreciation is a necessary expense to provide funds to replace worn-out equipment.[6] The expert testified that while the statement did not show "precise or exact" results of performance in the absence of an operating agreement, it did show the strength of Star in relation to the weak position of Citizen (A. 329). Pro forma statements are not an unusual device. Business decisions are made every day on the basis of such statements (A. 310) and government agencies, such as the SEC, accept pro forma statements as reliable data presented on the basis of projections and allocations drawn in accordance with generally accepted accounting principles, as used by the expert in this case (A. 330). Clearly, the government, in questioning the pro forma statement, is picking at straws.

Contrary to the government's assertion, the court did not reject appellants' claim that Citizen could not survive should the clauses in the operating agreement which provide for joint advertising and circulation departments be abrogated. Significantly, the court found that it was unable to predict what the operating results of either company in such a circumstance would be (F. 192). In light of the dismal history of the failure by newspapers to enter metropolitan markets occupied by an established newspaper,[7] it would be wrong to eliminate existing competition on the journalistic level be-

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[6] Cash flow analysis does not determine profit or loss but is used to determine whether the revenues of a business will provide funds for the payment of debts and the replacement of equipment (e.g., A. 343-344).

[7] See, e.g., Brief of American Newspaper Publishers Association as Amicus Curiae, Appendix II; Brief For Amici Curiae, pp 10-21.

tween Star and Citizen without even a reasonable probability that another newspaper could enter the market and reestablish that competition.

The government implies that the operating agreement hampers the vigorous competition that ordinarily exists between competing newspapers (G.B. 44). To the contrary, the Court found that "[*p*]*ursuant to the 1940 operating agreement,* Star Publishing and Citizen Publishing retained separate news and editorial staffs and engaged in intense rivalry with each other in the composition of news and editorial material . . ." (F. 31) (emphasis added). The Court further found that the "operating agreement has been successful" and that Start and Citizen "have provided the Tucson area with two newspapers of high quality" (F. 46).[8]

III. The Government Is Wrong in Its Contention That the Operating Agreement Is Per Se Illegal (See Government's Brief, pp. 21-24)

The government poses the *per se* question as follows: "[w]hether the price fixing, profit pooling and market allocation provisions of the 1940 agreement are unlawful *per se* under Section 1 of the Sherman Act" (G.B. 2). Phrasing the question this way assumes that *per se* labels of "price fixing", "profit pooling", and "market

[8] The government argues that the diversity of news and editorial policy and opinion is being maintained by an operating agreement which will be "perpetuated regardless of the subsequent growth of the market" and technological changes (G.B. 43). A subsequent change in market conditions may well evoke a reexamination in the light of changing circumstances and under the rule of reason. See *United States* v. *du Pont & Co.* (1957) 353 U.S. 586. The government's sheer speculation on appellant Citizen's future prospects (G.B. 16-17) is based on conjecture (not even "possibilities"), a test inapplicable to Sherman Act cases.

allocation" accurately characterize the provisions of the operating agreement and would compel the conclusion that these provisions are unlawful. The government goes on to argue a question not presented here, *i.e.*, whether *per se* violations can be justified by an application of the failing company doctrine (G.B. 20). But this is circular reasoning because the *per se* rule prevents consideration of facts showing reasonable justification. And the absence of reasonable justification is said, in turn, to require application of the *per se* rule.

The issue here is not whether *per se* restraints can be justified. The issue is whether the operating agreement constitutes an unreasonable restraint *per se* or otherwise. The government misstates our position when it states appellants contend that "lesser restraints" resulted from the 1940 agreement than from a complete merger (G.B. 20). We contend that the agreement did not result in any restraint at all. This is because it did not remove a viable competitor from the market, but instead salvaged the remnants of a failing newspaper and preserved competition at its separate, non-commercial level for the benefit of the Tucson community.[9]

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[9] In support of its argument that the operating agreement was illegal *per se* the government points to the testimony of Small and similar testimony of Mathews that "it was the purpose of the operating agreement to end that pre-existing competitive situation" (G.B. 8). These witnesses testified, of course, as laymen and did not mean to say that there had been "effective competition" between the two companies in the "economic" or "antitrust" sense. Instead they referred to the end of a long, hopeless struggle which had caused the failure of Citizen. This was that "self destructive" competition which "may exist for a time but only until bankruptcy or merger leaves the field to one firm." Kaysen and Turner, *Antitrust Policy* (Harvard University Press, Cambridge, 1965), p. 191.

When the government asserts that "there can be no real disagreement" that the challenged provisions of the agreement are "illegal *per se* by the decisions of this Court" (G.B. 22), it misstates the law, and again slides over the basic issue in the case, namely, whether the operating agreement is in fact illegal, *per se* or otherwise (See A.B. pp. 29-30, 49-52). The government asserts that because the two newspapers merged their commercial assets and operations the law also required them to merge and eliminate competition on the journalistic level (G.B. 24). This makes no sense and has no logic. It means that no competition at the news and editorial level is preferred to the actual competition which was preserved.

Respectfully submitted,

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